

Office of Chief Counsel  
Internal Revenue Service

**memorandum**

CC:SER:NFL:JAX:TL-N-6869-99

JFKearney:jcp

date: December 27, 1999

to: Chief, Examination Division, North Florida District  
(Attn: Revenue Agent Frank E. Glowaski)

from: District Counsel, North Florida District, Jacksonville

subject: [REDACTED]

In coming to a conclusion regarding the I.R.C. § 845(b) issue, we have a preliminary view that the reinsurance at issue (reference account) exhibits a significant tax avoidance effect. As pointed out, the bottom line is that over a [REDACTED] year period, \$ [REDACTED] per year vanishes as income. The taxpayer claims a current deduction and the reinsurer will offset premium income by the amount it estimates that it will have to pay back at the end of the policy. We believe that the facts in this case, when coupled with dicta in the recent United Parcel Service v. Commissioner, T.C. Memo. 1999-268 opinion regarding minimal risk shifting provides a general framework for our case. I.R.C. § 845(d) has been addressed by the Tax Court in Trans City Life Insurance Co. v. Commissioner, 106 T.C. 274 (1996)). There the Court, after noting the lack of regulations under this Code section, addressed seven factors set out in the conference report with respect to this Code section. Underlying these seven tests is an overriding principle the tax avoidance effect is significant "if the transaction is designed so that the tax benefits enjoyed by one or both parties to the contract are disproportionate to the risk transferred between the parties." H. Conf. Rept. 98-861, 1984-3 C.B. (Vol. 2) at 317. This overriding principle is resolved in favor of one party over the other by analysis of the seven factors as follows:

- i. Duration or age of business reinsured;
- ii. Character of Business Reinsured;
- iii. Determining Potential Profits and Experience Rating;
- iv. Duration of Agreement;
- v. Right To Terminate and Consequences of

Termination;

vi. Relative Tax Positions; and

vii. General Financial Situations.

An analysis of these seven factors will allow for determination of the relative risks transferred versus the tax benefits derived.

We are unable to effectively respond to each of these factors based on the facts we presently have available and request your assistance in the form of your providing your views on each of these factors as they relate to the reference account. Also, please provide your comments on the impact of the United Parcel Service decision that was rendered in the context of business purpose and the minimal risk shifting associated with the insurance at issue in that case. My initial reaction is that this entire transaction is similar in effect to that in United Parcel Service and that of a corporate tax shelter overlapping with the I.R.C. § 845(b) situation.

We note that unless the taxpayer extends the statute of limitation, there is no possibility of soliciting the technical advice. We would need at least a full year's extension for the technical advice to be accepted by the National Office. In the absence of such an extension and the seeking of a technical advice, the taxpayer will have to deal with our views (with or without their input). In this regard, we will coordinate with the National Office and with Tim Collins, the ISP, to the degree possible in order to have a unified position. We note that our preliminary discussions with the National Office have indicated that they believe we are dealing with a viable issue.

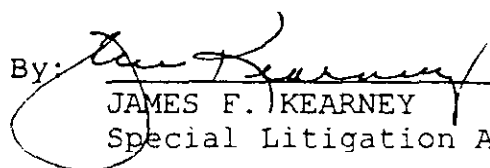
We suggest that the facts will necessarily have to be developed somewhat similar to those as developed in United Parcel Service in terms of the detail of the transactions. With respect to the instant case, it would require all the facts associated from negotiations between the parties' termination; why the taxpayer believes that a transaction fails GAAP for lack of risk transfers still qualifies for tax benefits under I.R.C. § 845(b); an analysis of the premiums paid with the risks assumed, which would require obtaining the evidence as to how the premiums were negotiated and computed; an analysis that will prove up the conditions set out in Rev. Rul. 83-66 with respect to retrospectively rated premiums and a determination as to whether the premium was actuarially determined in the manner of the actuarial determination; and, finally, access to Ernst and Young's computations for risk transfer under FASB 113.

We believe that the situation herein is distinguishable from the results in Trans City's Life Insurance Company, at least on the surface, in that the omitting of \$ [REDACTED] a year over a [REDACTED] year period from anyone's income would appear to be a significant tax impact.

We will be happy to assist in any way possible in terms of the factual development of this issue. In this regard, we should keep Tim Collins' read in on our factual development and potential theories as much as possible and I will seek to make contact with Tim within the next several days. Additionally, I will keep the National Office read in on our progress in order to ensure their backing throughout this process. I would agree with Tim's initial views that we believe we have a very favorable case for purposes of arguing under I.R.C. § 845(b), but that it would be necessary to properly frame the issue, both legally and factually. In this regard, the development of your facts and your comments with respect to the factors above will be important as the case will be decided at least to some degree, if not solely on the basis of those factors. I have attached copies of both United Parcel Service v. Commissioner and the Trans City Life Insurance Co. v. Commissioner cases for your convenience.

Again, please don't hesitate to call me at (904) 232-2788, Ext. 22 for discussions of this case and any of the factual developments as may be needed.

BENJAMIN A. de LUNA  
District Counsel

By:   
JAMES F. KEARNEY  
Special Litigation Assistant

Attachments  
As Stated